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CREDIT OPINION
29 March 2022

Update

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RATINGS

Empresa de Transmision Electrica, S.A.

Domicile	Panama
Long Term Rating	Baa2
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Empresa de Transmision Electrica, S.A.

Update to Credit Analysis

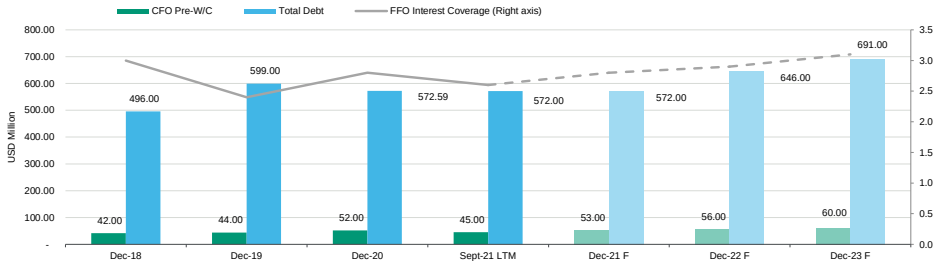
Summary

Empresa de Transmision Electrica, S.A. (ETESA) is a state-owned electricity transmission company in Panama, which is the sole operator and owner of the transmission system that mainly consists of three transmission trunk lines and several substation assets. ETESA, through a concession granted by the Government of Panama (Baa2 stable), has the exclusive rights for the transmission, operation and generation of electricity in the country, as well as conducting energy demand planning activities.

ETESA's credit profile mainly reflects the supportive regulatory framework under which it operates and the regulated tariff-setting process that allows the company to achieve a fixed return on its investments. ETESA is not exposed to volume or commodity risk; its revenue is derived from the periodic regulated tariffs that factor in the company's productive assets and capital spending.

The rating reflects the relatively high leverage and coverage metrics resulting from the planned investments. In the following exhibit it can be observed that in the last twelve months ended September 2021, ETESA reported a cash interest coverage ratio of 2.6x and funds from operations (FFO)/net debt of 8.2%. Our expectation incorporates a gradual implementation of the planned capital spending program and a likely tariff update that will lead to a cash interest coverage ratio of 2.9x and FFO/net debt of 9.8% as of year-end 2022.

Exhibit 1
Actual and projected FFO, total debt and coverage ratios



All ratios are based on 'Adjusted' financial data and incorporate Moody's global standard adjustments for non-financial corporations.
Financial metrics are based on our base case scenario.
Sources: ETESA and Moody's Investors Service

Credit strengths

» Exclusive rights to operate the transmission system in Panama

» Stable and predictable revenue from a transparent and clear tariff-setting process

» Sole ownership of the Government of Panama, which we assume to provide a high level of extraordinary support in case of need

Credit challenges

» An ambitious capital spending program will require external funding via debt, thereby keeping leverage relatively high.

» ETESA is required to compensate power generators for the electricity not delivered because of transmission system failures.

» The concession expires in October 2024, although renewal risk is low as ETESA is the only company allowed to operate the transmission system by law.

Rating outlook

ETESA's rating outlook is stable, in line with the rating outlook of the Government of Panama, the company's sole owner and extraordinary support provider in the event of financial distress. ETESA's regulated business model will likely continue to generate stable and predictable revenue over the next 12-18 months.

Factors that could lead to an upgrade

» Upward pressure on ETESA's rating would require the company to record a cash interest coverage and FFO/Net Debt above 3.5x and 13.0%, respectively, on a sustained basis and, importantly, an upgrade of Panama's sovereign rating.

Factors that could lead to a downgrade

» The rating would come under downward pressure if we see deterioration in the credit quality of the sovereign rating or change in our assessment of the implied government support.

» We could also downgrade ETESA's rating if its key financial metrics deteriorate, as a result of higher leverage or lower cash flow generation, such that its cash interest coverage and FFO/Net Debt were to remain below 2.8x and 9.0%, respectively, on a sustained basis.

Key indicators

Exhibit 2

Empresa de Transmision Electrica, S.A.

	Dec-20	Sept-21 LTM	Dec-21 F	Dec-22 F	Dec-23 F	Dec-24 F
FFO Interest Coverage	2.80	2.60	2.80	2.90	3.10	3.30
Net Debt / Fixed Assets	63.1%	62.3%	59.1%	63.8%	64.7%	65.3%
FFO / Net Debt	10.9%	8.20%	11.20%	9.80%	9.40%	9.50%
RCF / Net Debt	10.9%	8.20%	11.20%	9.80%	9.40%	9.50%

All ratios are based on 'Adjusted' financial data and incorporate Moody's global standard adjustments for non-financial corporations.
Financial metrics are based on our base case scenario.
Sources: ETESA and Moody's Investors Service

Profile

Founded in 1998, Empresa de Transmision Electrica (ETESA) operates the country's transmission network as a monopoly and is wholly owned by the Government of Panama. ETESA, granted by law, owns and oversees the operation and maintenance of the transmission

system, which consists of three transmission lines that span roughly 3,000 kilometers and 18 substations, providing interconnection between the power generation plants and regulated customers, which are primarily the three distribution companies in Panama. Additionally, the company dispatches energy according to market rules, performs energy demand planning activities and coordinates public auctions to secure supply to regulated customers.

Recent developments

In September 2021, ETESA declared void the tender for environmental studies of the fourth transmission line because none of the proposals complied with the minimum requirements, further delaying the project. In December 2021, a second tender process was announced, which is currently ongoing and the expected commercial operation date is 2025.

Detailed credit considerations

Regulatory framework and cash flow visibility will continue to support credit quality

ETESA has the advantage of operating in a monopolistic structure, having the exclusive rights to own and operate the transmission system in Panama under a long-term concession authorized by the regulatory body Autoridad de los Servicios Públicos (ASEP). The concession will expire in October 2024, well before the maturity of the rated debt; however, the renewal risk is minimal considering ETESA's sole ownership by the Government of Panama and its exclusive rights, granted by the law, to own and operate the transmission system. In December 2021, ETESA filed a formal request to renew the concession agreement in advance because a renewal of the agreement is imperative for the implementation of its planned capital spending program.

The strategic nature of this regulated activity is supported by a tariff-setting process that remunerates ETESA on the basis of its asset availability base. The tariff regime is revised every four years and sets a minimum allowed income that incorporates a 7% fixed rate of return plus the last-12-month interest rate of the 30-year US Treasury bonds (with a 2% deviation). This regime allows ETESA to achieve a rate of return that generates profit after covering operating and maintenance expenses. ETESA is not exposed to volume or resource risk as the tariffs are charged to generating and distribution companies. In the event any of those companies fails to carry out a payment, the amount is redistributed among the participants of the electricity system based on their market shares. Overall, the operating environment supports the company's credit strength.

The ambitious capital investment program to keep up with the growing capacity penetration will likely keep leverage high

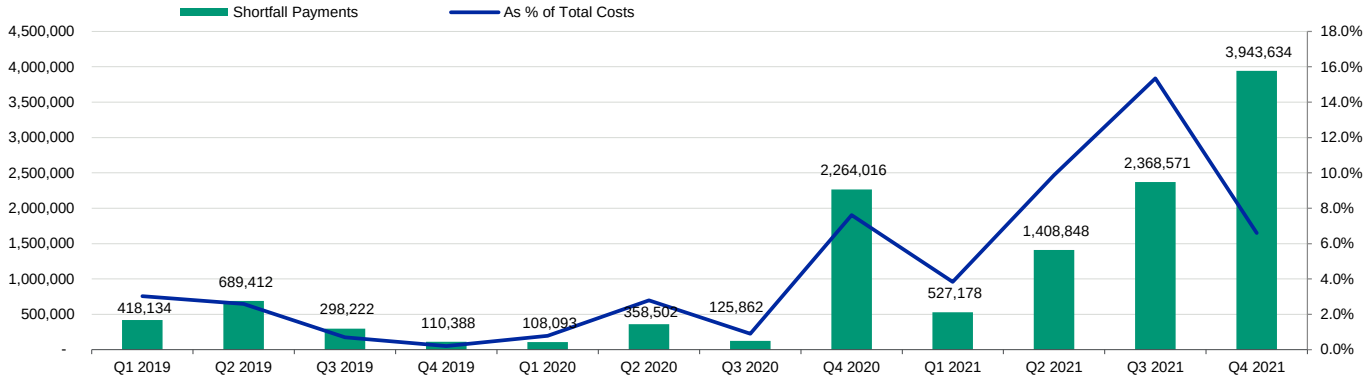
In Panama, the electricity demand has grown at an average annual rate of roughly 4% over 2000-20, with a slowdown in the last four years. After an around 6% decline in electricity demand in 2020 because of the pandemic-related lockdowns and restrictions, we expect the demand to rebound to 3.9% annually, which is in line with our GDP growth forecasts and ETESA's moderate scenarios in its generation expansion plan for 2020-34. Distribution companies in Panama need to secure and contract future energy supply in line with the projected peak demand levels to maintain a reserve margin; therefore, we expect important capacity additions in the system to occur from 2022 to 2025.

For 2020-25, the proposed capacity additions in ETESA's expansion plan include a total penetration of 775 megawatts (MW) of capacity, mainly from non-conventional renewables and thermal plants. This growth in capacity requires ETESA to expand and maintain the interconnection grid to avoid congestion issues. As a result, ETESA's capital spending program for 2022-25 will average at 15% of net fixed assets, a level that is appropriate for the current rating category. These capital investment needs will be funded with cash and additional debt, keeping leverage relatively high. Under our base case, ETESA will record average FFO/net debt of 9.6% over 2022-24 (versus 11.6% in 2019).

The construction of the planned fourth transmission line with an estimated cost of $550 million was delayed in 2021 because the participants in the auction process for the environmental studies did not comply with all the requirements. ETESA is continuing with the planning and development processes of this project and expects to commence operations by 2025. We expect the current capital spending plan to withstand the additional capacity penetration until 2024, but a further delay beyond 2025 could increase the risks of congestion and transmission shortfall.

In the event of a transmission shortfall, ETESA is required to compensate the affected parties for the electricity that was not delivered (this event is called Generación Obligada under local regulation). In the following exhibit it can be observed the amount of payments ETESA has been required to compensate as a consequence of these type of events. An important assumption embedded in our rating is that the fourth transmission line will be developed and built through a public-private partnership without recourse to ETESA's balance.

Exhibit 3
Transmission Shortfall Payments



Source: Centro Nacional de Despacho Statistics

Important links with the Government of Panama

ETESA's baa2 BCA is a measure of its standalone creditworthiness. Because the company is wholly owned by the Government of Panama, we apply the Government-Related Issuers methodology, which incorporates our view of a high level of implied government support in the event of financial distress, as well as a very high level of default dependence with the Government of Panama. These factors incorporate the importance of the company's services to the country's overall economic development and security.

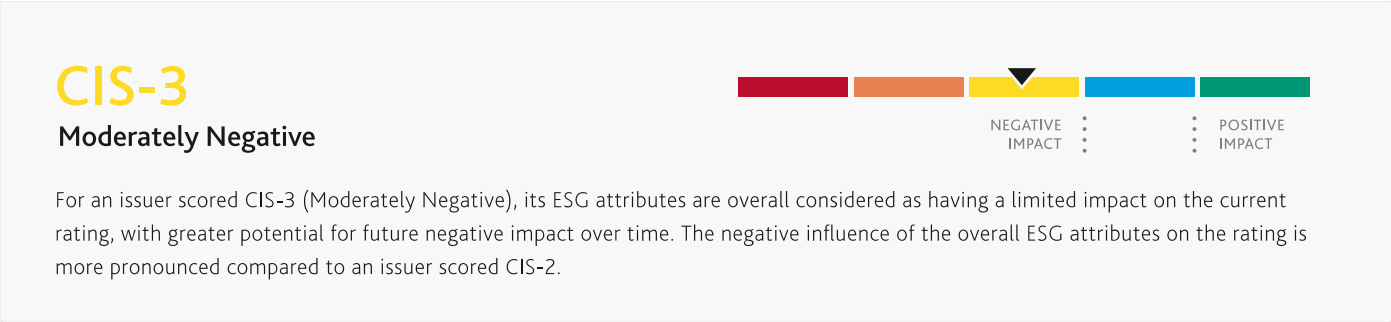
The government has supported ETESA with capital contributions of $68.7 million since 2011, as well as approved an extraordinary tariff increase, which resulted in an additional $80 million in revenue, to compensate for the Generación Obligada expense incurred because of the delay in the construction of the third transmission line. However, about half of the $80 million plus interest costs will be deducted from tariffs starting in 2023 to compensate the electricity market for the extraordinary tariff increase, and it will be fully repaid by 2037.

ETESA does not have a mandatory dividend distribution policy, and it often reinvests all of its net income in further development and expansion of more efficient transmission lines, which allows the company to set more competitive tariffs. Moreover, the board of directors is presided by the Minister of Economy and Finance, another evidence of linkages with the Government of Panama.

ESG considerations

EMPRESA DE TRANSMISION ELECTRICA, S.A.'s ESG Credit Impact score is moderately negative CIS-3

Exhibit 4
ESG Credit Impact score



Source: Moody's Investors Service

ETESA's ESG Credit Impact score is moderately negative (**CIS-3**), indicating that we consider its ESG attributes as overall having a limited impact on the current rating, with greater potential for negative impact over time. The score reflects neutral to low exposure to environmental risks and moderately negative exposure to social and governance risks.

Exhibit 5
ESG Issuer Profile scores

Source: Moody's Investors Service

Environmental

ETESA's exposure to environmental risks is neutral to low (**E-2** issuer profile score), reflecting its neutral to low exposure to risks related to carbon transition, physical climate, water management, waste and pollution, and natural capital.

Social

Exposure to social risks is moderately negative (**S-3** issuer profile score), reflecting the moderate risk from demographics and societal trends that increase public concerns over affordability issues, which could lead to adverse regulatory and political intervention. These risks are mitigated by neutral to low exposure to risks related to customer relationships, human capital, health and safety, and responsible production.

Governance

Governance risk is moderately negative (**G-3** issuer profile score) because of moderate exposures to management credibility and track record; and board structure, policies and procedures. Our governance score also considers a neutral to low exposure to the risks related to financial strategy and risk management, organizational structure, and internal controls.

ESG Issuer Profile scores and Credit Impact scores for the rated entity/transaction are available on www.moodys.com. To view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

The tariff-setting process that allows ETESA to achieve a rate of return after expenses mitigates liquidity risks. In addition, as of September 2021, ETESA held cash, equivalents and other short-term investments that roughly amount to $100 million and had no short-term debt maturities, with the next maturity being the principal repayment of $75 million senior local bonds due in 2026. The $500 million senior unsecured notes issued from international bonds amortize until 2035.

Methodology and scorecard

The methodologies used in these ratings were our Regulated Electric and Gas Networks, published in March 2017, and Government-Related Issuers Methodology, published in February 2020.

Exhibit 6
Rating factors
Empresa de Transmision Electrica S.A.

Empresa de Transmision Electrica, S.A. -Private				
Regulated Electric and Gas Networks Industry [1][2]	Current LTM 9/30/2021		Moody's 12-18 Month Forward View As of 3/7/2022 [3]	
Factor 1 : Regulatory Environment and Asset Ownership Model (40%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability and Predictability of Regulatory Regime	A	A	A	A
b) Asset Ownership Model	Baa	Baa	Baa	Baa
c) Cost and Investment Recovery (Ability and Timeliness)	A	A	A	A
d) Revenue Risk	Aa	Aa	Aa	Aa
Factor 2 : Scale and Complexity of Capital Program (10%)				
a) Scale and Complexity of Capital Program	Ba	Ba	Ba	Ba
Factor 3 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (40%)				
a) FFO Interest Coverage (3 Year Avg)	2.9x	Baa	2.9x	Baa
b) Net Debt / Fixed Assets (3 Year Avg)	67.5%	Baa	62.7%	Baa
c) FFO / Net Debt (3 Year Avg)	9.8%	Ba	10.1%	Ba
d) RCF / Net Debt (3 Year Avg)	9.8%	Baa	10.1%	Baa
Rating:				
Scorecard-Indicated Outcome Before Notch Lift		Baa2		Baa2
Notch Lift	0	0	0	0
a) Scorecard-Indicated Outcome		Baa2		Baa2
b) Actual Rating Assigned		Baa2		
Government-Related Issuer		**Factor**		
a) Baseline Credit Assessment		baa2		
b) Government Local Currency Rating		Baa2		
c) Default Dependence		Very High		
d) Support		High		
e) Actual Rating Assigned		baa2		

[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for nonfinancial corporations.
[2] As of 9/30/2021.
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Exhibit 7

Peer comparison

	Empresa de Transmision Electrica, S.A. Baa2 stable			Transelec S.A. Baa1 stable			Consorcio Transmantaro S.A. Baa3 stable			Interconexion Electrica S.A. E.S.P. Baa2 stable		
	FYE Dec-19	FYE Dec-20	LTM Sept-21	FYE Dec-19	FYE Dec-20	LTM Sept-21	FYE Dec-19	FYE Dec-20	LTM Sept-21	FYE Dec-19	FYE Dec-20	LTM Sept-21
Revenue (in USD millions)	132	144	139	540	422	438	190	193	196	2,045	1,879	1,952
EBITDA (in USD millions)	105	110	99	483	354	382	176	176	205	1,562	1,330	1,318
FFO Interest Coverage	2.4x	2.8x	2.6x	4.7x	3.6x	3.9x	4.0x	4.3x	3.5x	5.1x	4.1x	2.6x
Net Debt / Fixed Assets	71.0%	63.1%	62.3%	94.1%	85.2%	83.9%	63.4%	72.8%	72.8%	45.5%	50.6%	63.2%
FFO / Net Debt	8.3%	10.9%	8.2%	18.7%	14.6%	15.1%	16.5%	14.1%	11.6%	25.0%	18.1%	13.8%

[1] All figures and ratios calculated using Moody's estimates and standard adjustments. FYE = Financial year-end. LTM = Last 12 months.
Source: Moody's Financial Metrics™

Exhibit 8

Cash flow and credit metrics

Empresa de Transmisión Electrica S.A.

(In USD Millions)	Dec-17	Dec-18	Dec-19	Dec-20	LTM Sept-21
As Adjusted					
EBITDA	***36***	***79***	***105***	***110***	***99***
FFO	***44***	***42***	***44***	***52***	***45***
RCF	***44***	***42***	***44***	***52***	***45***
FFO	44	42	44	52	45
CFO Pre-WC	***44***	***42***	***44***	***52***	***45***
+/- ΔWC	*39*	*(48)*	*(29)*	*17*	*23*
CFO	***83***	***(6)***	***15***	***69***	***68***
- Capex	*55*	*84*	*86*	*46*	*67*
FCF	***28***	***(90)***	***(71)***	***23***	***2***
Debt / EBITDA	*3.9x*	*6.3x*	*5.7x*	*5.2x*	*5.8x*
Revenue	*107*	*126*	*132*	*144*	*139*
Cost of Good Sold	*62*	*37*	*22*	*20*	*24*
Interest Expense	*8*	*20*	*32*	*29*	*29*
Net Income	*1*	*10*	*23*	*10*	*3*
Total Assets	*863*	*979*	*1,040*	*1,034*	*1,061*
Total Liabilities	*551*	*655*	*694*	*679*	*706*
Total Equity	*312*	*323*	*346*	*355*	*356*

[1] All figures and ratios calculated using Moody's estimates & standard adjustments.
Source: Moody's Financial Metrics™

Exhibit 9

Moody's-adjusted debt breakdown

Empresa de Transmisión Electrica S.A.

(In USD Millions)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20	LTM Sept-21
As Reported Debt	**124**	**139**	**492**	**599**	**573**	**572**
Operating Leases	4	4	4	0	0	0
Moody's - Adjusted Debt	**128**	**143**	**496**	**599**	**573**	**572**

[1] All figures and ratios calculated using Moody's estimates and standard adjustments. FYE = Financial year-end. LTM = Last 12 months.
Source: Moody's Financial Metrics™

Ratings

Exhibit 10

Category	Moody's Rating
EMPRESA DE TRANSMISION ELECTRICA, S.A.	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2

Source: Moody's Investors Service

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